



# Lombard Street Research

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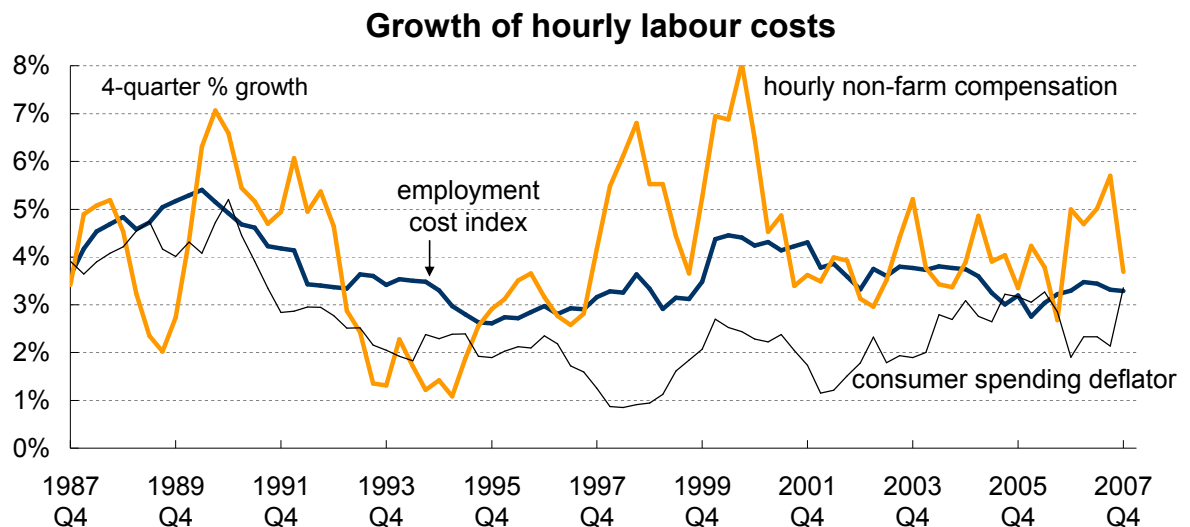
Daily Note: 6 February 2008

## Bang go the bonuses – and real US income growth

**WE SUGGEST: Wall Street has not discounted stagflation**

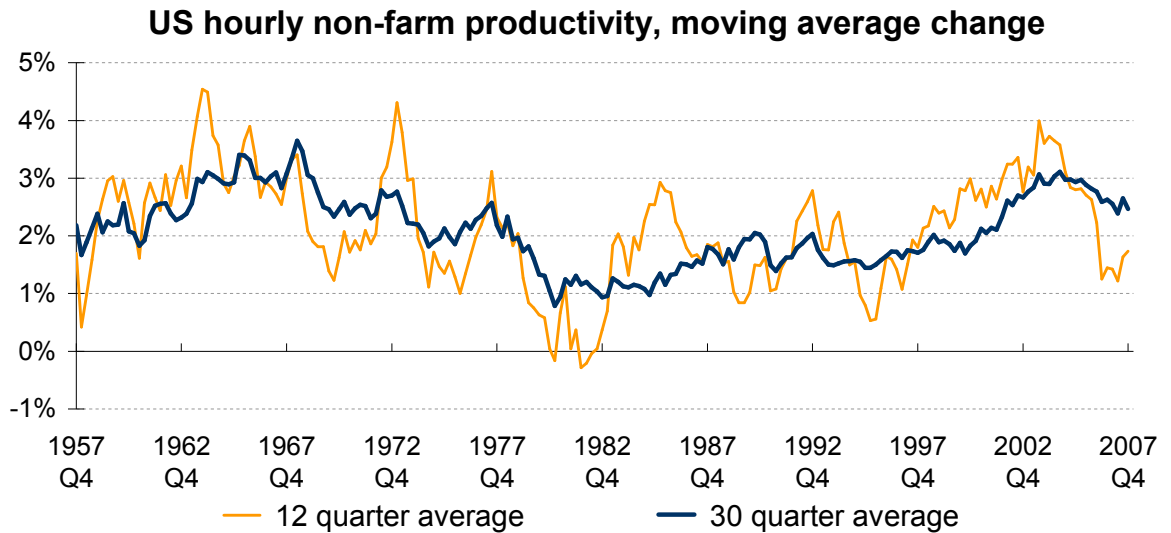
**SUMMARY: The hourly non-farm business compensation data for Q4 show the end of its premium growth vis-à-vis conventional payroll costs, which have been growing at 3-3¼%. US hourly labour income is now growing at or below the inflation rate.**

A key aspect of our forecast of a consumer spending recession is that the depressant to spending from falling house prices (raising the savings rate) would be reinforced by a sharp downswing in real income growth as unconventional sources of income – real estate commissions, bonuses, stock option profits – went ex-growth or even down. Combining much slower income growth with resurgent inflation – as China overheats and the Fed debases the dollar – is adding a third twist to the knife.



Today's fourth quarter productivity and labour cost report shows annual growth of hourly non-farm business compensation falling from 5.7% to 3.7% – entirely because the 2007 Q4 unconventional income was substituted for the much more vigorous 2006 Q4. Given what we now know about the mortgage business practices in 2006 Q4, it is doubtful if even real estate commissions were falling much by then, though housing and home transactions were falling fast. And certainly bonuses and stock options were booming. Hourly compensation growth was two percentage points faster than the Employment Cost Index, which measures normal wages, salaries and overtime, plus fringes like medical premiums, etc. By 2008 Q1 the growth of hourly compensation, incorporating by then the entire bonus season from this winter, should be at 3% or less, compared with a comparatively steady 3-3¼% for the ECI.

No near-term deceleration of headline inflation is in view, so real hourly labour income is likely to be growing at less than the rate of inflation in early 2008, having been exactly equal to it on a quarterly basis in Q4.



The news on productivity is that at least the worsening of the “de-cycled” 7½-year (30-quarter) moving average has stopped for a year now. The test here will be how much further the hard landing this year pulls this down, if at all. It will certainly cut productivity growth on a short-period basis, even as far out as the 3-year moving average. The 2½% 7½-year average, adjusted for declining weekly hours over time and little productivity growth in the uncovered sectors (mostly government), remains consistent with trend growth of 3% or a bit less.

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